

~~TOP SECRET~~~~ANNEX~~

7 October 1948

THE ACUTE CRISIS IN CHINA

The crisis confronting the Chinese National Government has become so acute that the end of 1948 may find Chiang Kai-shek heading a government which has been reduced to a militarily impotent and financially bankrupt regime in the Yangtze valley and South China.

The Communist armies, now conducting a coordinated offensive over an area extending from Manchuria to Central China, are rapidly acquiring a numerical preponderance in most sectors and possess a strategic reserve which the National Government is totally lacking. This means that Chiang Kai-shek is now incapable of adequately reinforcing any threatened position without weakening other areas extremely. The sudden fall of Tsinan, which the Nationalists had announced they were determined to hold at all costs, demonstrated that the Communists are now prepared to wage a campaign which includes assaults on large cities.

The Nationalist military position is most critical at present in the corridor leading into Manchuria, where the Communists are making a major effort to capture Chinhien. Chiang Kai-shek may be forced to withdraw completely from Manchuria in order to protect this sector. The situation is equally grave for the Nationalists along the rail line from Peiping into Suiyuan Province. South of the Yellow River, the Communists are now moving against the Nationalist armies along the Lunghai railroad, the last important line of defense north of Nanking. Major military reverses during the next three months may annihilate or finally isolate what remains of the demoralized Nationalist military forces north of the Yangtze.

It is possible that a Communist advance into Central China may be postponed by the problems of military supply and the desirability of Communist political and economic consolidation in occupied areas. The success the Communists are now having in solidifying their political control of North China may facilitate political consultations among Communist and dissident Nationalist elements. Such consultations will be directed toward the eventual establishment of a rival government of China, which the Communists undoubtedly would dominate.

~~TOP SECRET~~

TOP SECRET

The National Government is also losing its present gamble for economic stability. Evidences of weakness in the new currency have already appeared. A widespread loss of faith in the new currency, leading to a return of uncontrolled inflation, will be an inevitable consequence of serious military defeats. Nationalist economic potential is further threatened by the probable Communist capture of the Kailan coal mines in North China which will cripple industry in Shanghai and other large cities.

In this desperate plight, factions within the National Government may seek a solution for Chinese internal problems through a sharp shift in foreign policy. Some Nationalist leaders may undertake to side with the US against the USSR on all international issues in the hope that the US might thereby be induced to assume greater responsibility for the Government's survival. On the other hand, an increasing desire for a compromise peace with the Communists will support the policies of those Nationalist officials who hope that the USSR may mediate a satisfactory settlement. The USSR may attempt to capitalize on this compromise sentiment by offering mediation and a new general understanding with China. However, a Nationalist-Communist compromise settlement could be negotiated only on terms very favorable to the Communists and probably would require an upheaval at Nanking and the departure of Chiang Kai-shek. Although Chiang's prestige and influence are at a low ebb, no other Nationalist leader or group appears prepared or willing, at the moment, to take over power.

The recent Communist victory at Tsinan has increased the possibility of a move against Tsingtao and a possible clash with US forces there. Present Communist troop dispositions, however, indicate the unlikelihood that an immediate assault will be made on Tsingtao. The primary threat to the US position in China lies in the steadily deteriorating situation of the National Government, largely caused by military reverses. In view of the inefficiency and ineptitude of the Nationalist high command, the low morale in its armies, the lack of trained reserves, and the tendency of regional leaders to give first consideration to their local interests, the present military situation of the National Government appears irretrievable. This situation probably would not be significantly altered even if currently planned US aid were made immediately available in China.

TOP SECRET

CONFIDENTIAL

